COUNCIL ON INDUSTRIAL COMPETITIVENESS ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON ECONOMIC STABILIZATION

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

SECOND SESSION

ON

H.R. 2373

A BILL TO IMPROVE THE INDUSTRIAL COMPETITIVENESS OF THE UNITED STATES

MARCH 19, 1986

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COUNCIL ON INDUSTRIAL COMPETITIVENESS ACT

WEDNESDAY, MARCH 19, 1986

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON ECONOMIC STABILIZATION,
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,
Washington, DC.

The subcommittee met, pursuant to call, at 9:45 a.m., in room 2220, Rayburn House Office Building, Hon. John J. LaFalce (chairman of the subcommittee) presiding.

Present: Chairman LaFalce, Representatives Torres, Carper, and Wortley.

Chairman LAFALCE. The Subcommittee on Economic Stabilization of the Committee on Banking will come to order.

In April 1984, the House Banking Committee reported out legislation—the Industrial Competitiveness Act—which would have been a critical first step in creating an industrial competitiveness strategy for this country. I had introduced that legislation because of my firm conviction that failure to develop such a strategy would fundamentally jeopardize this country's ability to compete in the world marketplace. I believe time has proven supporters of that legislation correct.

At that time, our competitive problems had already garnered widespread attention. Now, almost 2 years later, the situation has deteriorated dramatically. Our trade deficit last year was a staggering $150 billion, and it is still on the rise. By most measures, manufacturing remains in a disasterous condition.

In current dollars, the sector has plunged from a peak of 30 percent of U.S. GNP in 1953 to about 21 percent in 1985. Durable goods production has tobogganed downward. In 1953, one out of every three nonfarm workers was in manufacturing; today the ratio is roughly one out of five.

There is no easy salvation to be found in our high technology or service sectors. The semiconductor and telecommunications industries have joined the machine tool and textile industries in complaining of severe pressure from foreign competitors. The deteriorating trade surplus of our service sector is proving that it is no more invulnerable to increased international competition than our auto and steel industries have been.

Experts have argued that the overvalued dollar is responsible for half to two-thirds of our $150 billion trade deficit. Even if this were true, the $50 to $75 billion deficit that would remain would still be a substantial cause for concern.

Moreover, the dollar vis-a-vis the yen is the weakest it has been in years, and yet we will still incur a substantial trade deficit with Japan this year. I suspect we will also incur a substantial trade deficit with Japan and other countries in future years, too, and that we will find out that the overvalued dollar was not responsible for half to two-thirds of our $150 billion trade deficit.

In any event, we simply cannot rely on exchange rate policy alone despite its importance, to revitalize those industries which have proven themselves to be vulnerable to strong foreign competition. If our competitive performance is profoundly disturbing, our Government's policy response is more disturbing still. At a time when our foreign competitors are moving aggressively to enhance their positions in world markets, we are allowing our competitive decline to continue unabated.

It is not that we are reluctant to embrace policies providing assistance to industry. We have dozens of them, hundreds of them, maybe thousands of them, and they cost American taxpayers billions of dollars each year. What we seem unwilling to do is organize these policies into a comprehensive strategy capable of advancing our own competitive interests.

Current policies are designed and implemented randomly and in isolation from each other, with no evaluation of their impact on the competitive position of the industries they are supposed to assist. At a time when it is imperative that Government, business, labor, academia, and public interest groups act together to develop long-term strategies to ensure the international competitiveness of U.S. industries, adversarial relationships remain typical. No high level forum exists for developing a consensus on economic policies affecting industry.

When this issue was being discussed 2 years ago, dozens of reports on the long-term competitiveness of the American economy were being issued by commissions involving leaders from virtually all of the leading companies, unions, academia, public policy institutes, foundations, and many private citizens. Given the diversity of the groups and individuals involved, the extent of the agreement was rather amazing.

One item on which there was clear consensus was that a major obstacle to improving U.S. competitiveness is the stunning confusion that characterizes the U.S. policymaking process. In report after report, a principal recommendation was the need for better coordination of the various Government actions that influence business activities and U.S. participation in the global marketplace.

Groups as diverse as the Business-Higher Education Forum, the President's Commission on Industrial Competitiveness, the AFL-CIO, and the White House Conference on Productivity concurred that we need an institutional mechanism to focus attention on competitiveness issues in the policymaking process and develop consensus regarding our economic goals. To quote the President's own Commission, "mechanisms should be developed for building consensus among key sectors of society to better respond to our competitive challenges."

The centerpiece of my proposal to develop an industrial strategy for this country was and remains the creation of a Council on Industrial Competitiveness—an independent entity with membership

drawn from the ranks of business, labor, Government, academia, and public interest groups. The Council is designed to increase our ability to help American industry compete in world markets and to provide better coordination and rationalization of existing Federal programs. It would provide the mechanism we need for achieving consensus on a competitiveness strategy for our economy and for specific sectors.

The Congress will soon begin deliberations on a trade bill. Existing trade laws do require close scrutiny. But we must not allow ourselves to succumb to the illusion that we can miraculously turn our trade deficit around merely with changes in trade laws and trade relief procedures. If we do not address the underlying structural problems inhibiting our ability to compete, little will change. The creation of a Council would be an important beginning.

Today we are pleased to have with us three of the most knowledgeable persons in the United States concerning these issues—all three have testified before our subcommittee previously, all three have given excellent presentations in the past.

Mr. Pat Choate of TRW, Lester Thurow of MIT, and Henry Schechter of the AFL–CIO.

At this time I will insert in the record the opening remarks of the ranking minority member, Mr. Shumway, without objection.

[The prepared statement of Mr. Shumway follows:]

STATEMENT OF THE HONORABLE NORMAN D. SHUMWAY

Thank you, Mr. Chairman. I join you in welcoming our distinguished panel of witnesses as we examine what role the Federal Government should play in setting the course of U.S. industry, specifically, whether our existing policy-making process adequately addresses competitiveness issues confronting our industry.

The issue of whether the United States needs a national industrial policy has been debated extensively since this country fell into the recessionary times of the early 1980s. High inflation and interest rates wracked the economy. Our traditional and more mature labor-intensive industries faced quality competition from low-wage developing countries and our high-tech industries faced unfairly subsidized competitors. Things did not look rosy then. Proponents of government intervention into and management of our economy alleged that our country was "deindustrializing" and could not meet foreign competition.

Despite the blistering economic recovery of 1984, the economic forecast still appeared grim, even at year-end 1985, as our federal budget and trade deficits reached inordinate levels. Calls for protectionist measures grew concomitantly with each increase in the value of the dollar.

These are two different economic scenarios and yet the same bad prescription is being offered to what I believe is a relatively healthy patient. As I said then and I say today, America is not deindustrializing. There are structural problems, as one should expect in a changing economy and the solution to some of these problems may require changes in government initiatives. But the changes should not be made on the microeconomic level, as the proponents of industrial policy would suggest.

Establishing a Council on Industrial Competitiveness will not improve the climate for American international competitiveness. Instead, it is a step along the road to centralized economic planning. There is ample evidence that centrally planned economies are less efficient, and less competitive, than free market economies. I am concerned that if we pursue this course, the government will inevitably emerge as the dominant force and politicize the process. Decisions would not be made based on economic objectivity.

The Government can, however, play a very effective role in fostering economic productivity and competitiveness by pursuing policies that will improve macroeconomic conditions. And, I might note, we are taking these steps right now and they are having a positive effect on our economic environment. For example, the mandatory budget cuts and the coordinated effort to push the U.S. currency down have produced lower interest rates, improved the outlook for American firms under seige

from imports. Wall Street has regained confidence in America's industrial sector as stock prices have surged with the anticipated profits.

We still have a long way to go. But it is a good start. While the U.S. must adjust to the new global competitive environment, we are fully capable of doing so. I would remind my colleagues, however, that the final determinant of competitiveness rests not in government management but in the productivity of individual firms. Let us heed the words of Thomas Jefferson then, when he said, "the merchants will manage commerce the better the more they are left free to manage for themselves." They were appropriate at the inception of our country and they are appropriate now.

Chairman LAFALCE. Mr. Torres.

Mr. TORRES. No statement, Mr. Chairman.

[The text of H.R. 2373, and summary follow:]

I

99TH CONGRESS
1ST SESSION

H. R. 2373

To improve the industrial competitiveness of the United States.

IN THE HOUSE OF REPRESENTATIVES

MAY 7, 1985

Mr. LAFALCE introduced the following bill; which was referred to the Committee on Banking, Finance and Urban Affairs

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A BILL

To improve the industrial competitiveness of the United States.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE

SECTION 1. This Act may be cited as the "Council on Industrial Competitiveness Act".

FINDINGS AND PURPOSE

SEC. 2. (a) The Congress hereby finds that—

(1) the preeminence of the United States in international industrial competition is seriously threatened and the insulation of United States domestic markets from international competition is at an end;

(2) the United States has been slow to accept and adapt to the reality of a highly competitive global marketplace and to regard the industrial development of competing countries as a challenge and an opportunity for its own economic growth;

(3) some major consequences of this failure to adapt are unnecessary plant closings, high unemployment, and a deterioration in the quality of jobs available for American workers;

(4) to be successful in the world arena, the United States must address the erosion of comparative advantage of its basic industries in a number of areas, including innovation, investment, and productivity;

(5) efforts to reverse the decline of American industry have been hindered by a number of factors, including—

(A) a long-term decline in relative productivity growth;

(B) insufficient capital investment in the revitalization of basic industries and in the commercialization and diffusion of new technologies;

(C) a lack of adequate patient capital to invest in smaller, innovative firms;

(D) insufficient investment in civilian research and development in comparison with our major competitors;

(E) a series of systemic inefficiencies in the management and organization of business, including adversarial labor-management relations and short-term time horizons; and

(F) a serious erosion in the institutional support for production, including a lack of high quality domestic and international economic data needed to—

(i) reveal sectoral strengths and weaknesses;

(ii) identify potential new markets and future trends; and

(iii) provide necessary information regarding the industrial strategies of our foreign competitors;

(6) helping to support the competitiveness of United States industries is a proper and necessary role for government, working with the private sector;

(7) at present, industrial policy in the United States is composed of a variety of Government programs, subsidies, and regulatory oversight functions

which often are neither coordinated, cohesive, nor consistent:

(8) while our economy benefits when business, labor, government, academia, and public interest groups work together cooperatively, there exists no effective, high-level forum for developing a consensus on economic policies;

(9) the decline in United States industrial competitiveness endangers the economic stability of the Nation;

(10) such decline also endangers the ability of the United States to maintain the defense industrial base which is necessary to the national security of the United States;

(11) progress on the issue of competitiveness requires a recognition that the world is moving rapidly toward the creation of an integrated and interdependent economy, a world economy in which the policies of one nation have a major impact on other nations;

(12) effective management of such an integrated world economy requires a significant increase in multilateral solutions on such issues as trade, tax, investment, and the distribution of world markets and world production;

(13) effective participation by the United States in this process has been inhibited by the lack of specific mechanisms—

(A) to identify the problems of particular industries and sectors; and

(B) to develop specific solutions to those sectoral problems within the broader range of national economic policies;

(14) such lack of specific mechanisms has been particularly harmful to those labor intensive industries which must compete with very low wages paid in foreign countries;

(15) it is now imperative that Government, business, labor, academia, and public interest groups act together to develop and coordinate long-range strategies for helping to assure the international competitiveness of United States industries; and

(16) such strategies should be balanced by—

(A) encouraging the development of emerging industries which can provide substantial economic growth and employment; and

(B) directing resources into the revitalization of mature and linkage industries.

(b) It is the purpose of this Act—

(1) to develop recommendations for long-range strategies for promoting the international competitiveness of United States industries; and

(2) to establish the Council on Industrial Competitiveness which will—

(A) gather and analyze information regarding the competitiveness of United States industries;

(B) create an institutional forum where national leaders with experience and background in business, labor, government, academia, and public interest activities will—

(i) identify economic problems inhibiting the competitiveness of United States industries;

(ii) develop long-term strategies to address such problems; and

(iii) create a broad consensus in support of such strategies; and

(C) make recommendations on issues crucial to the development of coordinated industrial strategies.

ESTABLISHMENT

SEC. 3. There is established in the executive branch of the Government an independent agency to be known as the Council on Industrial Competitiveness.

DUTIES OF THE COUNCIL

SEC. 4. The duties of the Council are—

(1) to collect and analyze relevant domestic and international data concerning current and future economic trends and market opportunities;

(2) to monitor the changing nature of the United States industrial economy and its capacity—

(A) to provide marketable goods and services in domestic and international markets; and

(B) to respond to international competition;

(3) to prepare and publish reports containing the recommendations of the Council with respect to industrial development priorities;

(4) to create a forum or forums where national leaders with experience and background in business, labor, academia, public interest activities, and Government will—

(A) identify national economic problems;

(B) develop recommendations to address such problems; and

(C) create a broad consensus in support of such recommendations;

(5) to establish industry subcouncils of public and private leaders to develop similar long-term strategies for sectors of the economy;

(6) to provide policy recommendations and guidance to the Congress, the President, and the Federal departments and agencies regarding specific issues concerning industrial strategies;

(7) to annually report to the President and the Congress—

(A) on the state of the national economy;

(B) on the status of major sectors of the national economy; and

(C) on the effect of existing Government policies on industries;

(8) to review and evaluate specific policy recommendations developed by the industry subcouncils and transmit such recommendations to the implementing agencies concerned; and

(9) to evaluate existing Government policies and business practices in terms of the competitive impact of such policies and practices.

MEMBERSHIP

SEC. 5. (a) The Council shall be composed of sixteen members as follows:

(1) four members appointed by the President, who shall be heads of Federal departments or agencies, Members of Congress, or representatives of State or local governments;

(2) four members appointed by the President, by and with the advice and consent of the Senate—

(A) who shall be national leaders with experience and background in business, including at least one individual selected from the small business community; and

(B) who shall have a broad understanding of the United States economy and the United States position in the world economy;

(3) four members appointed by the President, by and with the advice and consent of the Senate—

(A) who shall be national leaders with experience and background in the labor community; and

(B) who shall have a broad understanding of the United States economy and of the United States position in the world economy; and

(4) four members appointed by the President, by and with the advice and consent of the Senate, each of whom—

(A) shall be selected from the academic community or have been active in public interest activities; and

(B) shall have a broad understanding of the United States economy and of the United States position in the world economy.

(b) The Council shall not commence its duties until all the members specified in paragraphs (2), (3), and (4) of subsection (a) have been appointed and have qualified.

(c)(1) A vacancy in the Council shall be filled in the same manner in which the original appointment was made.

(2)(A) Any member appointed to fill a vacancy occurring before the expiration of the term for which such member's predecessor was appointed shall be appointed only for the remainder of such term.

(B) A member may serve after the expiration of such member's term until such member's successor has taken office.

(d)(1) No member may serve more than two consecutive terms.

(2) Members of the Council may be removed by the President only for malfeasance in office.

(e) Not more than nine members of the Council shall be of the same political party.

(f)(1) Members appointed under paragraphs (2) through (4) of subsection (a) shall be appointed for terms of six years.

(2) Of the members first appointed—

(A) three shall be appointed for a term of two years;

(B) three shall be appointed for a term of three years;

(C) three shall be appointed for a term of four years; and

(D) three shall be appointed for a term of six years; as designated by the President at the time of appointment.

(g)(1) Each member of the Council who is not otherwise in the service of the Government of the United States or any State or local government—

(A) shall receive a sum equivalent to the compensation paid at level II of the Executive Schedule, pursuant to section 5315 of title 5, United States Code, prorated on a daily basis for each day spent in the work of the Council; and

(B) shall be paid actual travel expenses, and per diem in lieu of subsistence expenses when away from his usual place of residence, in accordance with section 5703 of such title.

(2) Each member of the Council who is otherwise in the service of the Government of the United States or any State or local government shall serve without compensation in addition to that received for such other service, but while en-

gaged in the work of the Council shall be paid actual travel expenses, and per diem in lieu of subsistence expenses when away from his usual place of residence, in accordance with subchapter 1 of chapter 57 of title 5, United States Code.

(h) Nine members of the Council constitute a quorum, except that a lesser number may hold hearings if such action is approved by a two-thirds vote of the entire Council.

(i)(1) The Council shall elect, by a two-thirds vote of the entire Council, a Chairman from among the individuals appointed under paragraphs (2) through (4) of subsection (a).

(2) The Chairman shall serve full time.

(j) The Council shall meet at the call of the Chairman or a majority of its members, except that the Council shall meet not less than six times during each calendar year.

(k)(1) Each member of the Council shall designate one alternate representative to attend any meeting that such member is unable to attend.

(2) In the course of attending any such meeting, an alternate representative shall be considered a member of the Council for all purposes, including voting.

(l)(1) Except as provided in subsection (j), no action whatsoever (whether involving administrative or personnel matters, establishing policy, or any other type of action) shall be taken by the Council unless approved by two-thirds of the entire membership of the Council.

(2)(A) In the event that a two-thirds consensus, as required under paragraph (1), cannot be reached on a matter referred to the Council by the President, or either House of the Congress, the Council shall transmit a report to the President and both Houses of the Congress explaining why a consensus could not be reached on such matter.

(B) Such report shall include all information gathered by the Council on such matter and a list of potential policy options for addressing the concern involved.

(m) The Council may procure temporary and intermittent services under section 3109(b) of title 5, United States Code, but at rates for individuals not to exceed the daily equivalent of the maximum annual rate of basic pay for GS–16 of the General Schedule.

(n) Upon request of the Council, the head of any other Federal agency is authorized to detail, on a reimbursable basis, any of the personnel of such agency to the Council to assist the Council in carrying out the Council's duties under this title.

EXECUTIVE DIRECTOR AND STAFF

SEC. 6. (a)(1) The principal administrative officer of the Council shall be an Executive Director, who shall be appointed by the Council.

(2) The Council shall consult with the President and leaders of the Congress before appointing an individual to the position of Executive Director.

(3) The Executive Director shall serve full-time.

(b) Within the limitations of the Council's appropriations, the Executive Director may appoint the personnel of the Council in accordance with the civil service and classification laws.

POWERS OF THE COUNCIL

SEC. 7. (a) The Council may, for the purpose of carrying out the provisions of this Act, hold such hearings, sit and act at such times and places, take such testimony, and receive such evidence, as the Council considers appropriate. The Council may administer oaths or affirmations to witnesses appearing before the Council.

(b) If so authorized by the Council, any member or agent of the Council may take any action which the Council is authorized to take under this section.

(c)(1)(A) The Council may secure directly from any department or agency of the United States information necessary to enable the Council to carry out the provisions of this Act.

(B) Upon request of the Chairman of the Council, the head of such department or agency shall furnish such information to the Council.

(2) In any case in which the Council receives any information from a department or agency of the United States, the Council shall not disclose such information to the public unless such department or agency is authorized to disclose such information pursuant to Federal law.

(d) The Council may accept, use, and dispose of gifts or donations of services or property.

(e) The Council may use the United States mails in the same manner and under the same conditions as other departments and agencies of the United States.

(f) The Administrator of General Services shall provide to the Council, on a reimbursable basis, such administrative support services as the Council may request.

(g)(1) The Council shall establish, when and for such period of time as the Council deems appropriate, industry subcouncils of public and private leaders representing the major economic interests affected by sectoral policies.

(2) Subcouncil members shall serve on a part-time basis.

(3)(A) Such subcouncils shall examine the competitive problems facing individual industries in the economy and develop recommendations regarding long-term strategies which could improve the competitiveness of such industries.

(B) In the course of developing recommendations, the industry subcouncils shall hold such hearings, sit and act at

such times and places, take such testimony, and receive such evidence as such subcouncils consider appropriate.

(4)(A) The industry subcouncils shall report their findings and recommendations to the Council.

(B) Where appropriate, each of the subcouncil's reports shall assess the effectiveness of employee ownership as one of the tools and long-term strategies for improving the competitive problems facing the industry.

(C) The Council shall review the findings and recommendations of the subcouncils in preparing the Council's recommendations.

EFFECTS OF IMPORTS ON DOMESTIC INDUSTRIES

SEC. 8. (a) The Council shall examine and make available to the public all international agreements on foreign trade that have been agreed to by the United States.

(b) The Council shall continuously monitor, and maintain public records regarding, the effect of imports on all major United States industries and on such other United States industries as may be specified by the Council.

REPORTS

SEC. 9. (a) Not later than one year after the date of the enactment of this Act, the Council shall transmit a report to both Houses of the Congress and the President containing recommendations of the Council for changes in any Federal policy necessary to implement effective industrial strategies.

(b)(1) The Council shall annually prepare and transmit to the President and to each House of the Congress a report setting forth—

(A) the major industrial development priorities of the United States;

(B) the policies needed to meet such priorities; and

(C) a summary of existing Government policies affecting industries.

(2) Such report shall contain a statement of the findings and conclusions of the Council during the previous fiscal year, together with any recommendations of the Council for such legislative or administrative actions as the Council considers appropriate.

(c)(1) Upon receipt by either House of the Congress, the report shall be referred to the appropriate committee or committees of each House.

(2) The Council shall consult with each such committee with respect to such report and, following such consultation, each such committee shall submit to its respective House a report setting forth the views and recommendations of such committee with respect to the report of the Council.

AUTHORIZATION OF APPROPRIATIONS

SEC. 10. There are authorized to be appropriated for fiscal year 1986 not to exceed $50,000,000 to carry out the provisions of this Act.

DEFINITIONS

SEC. 11. For purposes of this Act—

(1) the term "Council" means the Council on Industrial Competitiveness established under section 3;

(2) the term "member" means a member of the Council on Industrial Competitiveness; and

(3) the term "United States" means the several States, the District of Columbia, the Commonwealth of Puerto Rico, Guam, the Virgin Islands, the Northern Mariana Islands, the Trust Territory of the Pacific Islands, American Samoa, and any other territory or possession of the United States.

○

SUMMARY OF H.R. 2373, THE COUNCIL ON INDUSTRIAL COMPETITIVENESS ACT

H.R. 2373 authorizes the creation of a Council on Industrial Competitiveness. The 16-member Council is an independent entity with membership drawn from business, labor, government, academia and public interest groups. It would provide a forum in which these groups could work cooperatively to develop a long-term competitiveness strategy for our economy and for specific industries and sectors.

The Council would also analyze the impact of existing federal programs and policies affecting industry to make recommendations for policy changes that would coordinate and redirect these programs into an overall strategy promoting growth and competitiveness.

DUTIES

The duties of the Council include:

1. Reviewing legislative and executive policies which affect industrial competitiveness.
2. Collecting and analyzing data regarding current and future economic trends and market opportunities.
3. Establishing industry sub-councils to develop long-term strategies for individual sectors.
4. Reporting annually to the President and Congress on ways to increase American competitiveness in world markets.
5. Building a national consensus on strategies for fostering the growth and competitiveness of American industry.
6. Examining all international agreements on foreign trade agreed to by the United States and monitoring the effect of imports on U.S. industries.

MEMBERSHIP

The Council would consist of 16 members, evenly divided between the government, business, academic and public interest, and labor communities.

EXECUTIVE DIRECTOR AND STAFF

The Council would appoint a full-time Executive Director who would serve as principal administrative officer. The staff of the Council would be hired in accordance with the civil service and classification laws.

POWERS

The Council may hold hearings, obtain information directly from U.S. departments or agencies, and establish sub-councils, but it does not have the power to subpoena.

FUNDING

The authorization level for the Council is $50,000,000 for FY 1986.

Chairman LAFALCE. We will put the prepared testimony of the three witnesses in the record, and you may feel free to summarize your remarks as you wish at this time.

Mr. Choate.

STATEMENT OF PAT CHOATE, DIRECTOR OF POLICY ANALYSIS, TRW, INC.

Mr. CHOATE. Thank you very much, Mr. Chairman.

I am pleased to have this opportunity to share thoughts with you and the committee again this morning, in particular on H.R. 2373.

As your previous hearings have highlighted, and the variety of studies have documented, the American Government influences the vitality of American business in many ways. The Harvard Business Review, in a 1985 article, estimated that half of all actions taken by American business are in direct response to the decisions of Government. As you correctly recognize in H.R. 2373, the tech-

niques of public administration have not kept pace with that reality. By very design, our Government consists of a splintering of power. For example, authority in Congress is divided at present among 8 select and special committees, 38 full committees, and 242 subcommittees. The splintering of power in Congress parallels the similar fragmentation in the executive branch.

Since the New Deal, dozens of new agencies and hundreds of programs have been created. Indeed, what we find is that decisions are atomized among 8 major offices within the Executive Office of the President, including OMB, 13 departments, 55 independent agencies, and hundreds of individual programs.

Now, I think most of us recognize that most Government decisions require decisions by the executive and the congressional branch before action can be taken. But because of the splintering of power, what we now find is, for example, that a modification of Federal pension policies will involve 10 Cabinet departments, 25 operating groups within those departments, and 119 congressional committees.

Shifts in economic policymaking involve 33 separate agencies outside the Executive Office of the President. Trade policies are split among the USTR, OMB, Council of Economic Advisers, Secretary of Commerce, Secretary of State, and 24 other departments, and, of course, 19 committees and subcommittees of the Congress.

This complex system creates gridlock, duplication, delays, omissions, and unintended consequences which this committee has, I think, fully documented in its hearings.

The question is how, given the reality that most of these interventions will continue, and that most of these individual interventions are warranted and are necessary, how can we bring some coherence and focus to these interventions, particularly as they affect American competitiveness?

It seems to me off the bat we should begin with the basic assumption that massive Government reorganization is a sterile approach to taking on this task, and indeed, since 1948 there have been 27 separate attempts to reorganize the economic policymaking functions outside of the Executive Office of the President, none of these massive efforts have succeeded.

Including so far the effort to create a Department of Trade and Industry.

So in my own mind, reorganization is typically a waste of time. There are other techniques that are possible. This administration has very creatively used an approach called Cabinet Councils in which a variety of topics have been used or specific topic areas have been used to form Cabinet Councils around those topics, such as economic activities and others. Even that has limitations and, as you also know, in February of last year, the administration abandoned that approach and consolidated the Cabinet Council approach to one mega Cabinet Council which is now chaired by the Treasury.

Ultimately such approaches flounder on the interdepartmental turf battles that are a natural consequence of fragmentation of power. What it seems to me is now required is to take a look at these reports that have been issued over the past several years that were cited by the chairman in his opening comments.

What is clear about it from these reports from knowledgeable individuals from both within Government and from business and academia and policy institutes and organized labor—in other words the whole spectrum of our society—is that we need to take within the existing structure of Government we now have, and devise techniques that will permit us to focus attention on specific issues such as competitiveness.

What is, I think, particularly important about these studies is that most of them come to the conclusion that we need a process and we need a small mechanism in the executive branch, preferably in the Executive Office of the President, that would be analogous to the National Security Adviser, in effect the National Security Adviser and National Security Counsel serves the function of the coordinator, neutral broker, between the State Department, Department of Defense, the Central Intelligence Agency, National Security Agencies, and others, to reconcile their objectives to harmonize their actions to ensure that we have a common focus on the important national security issues.

No counterpart exists for trade and for U.S. competitiveness issues.

At its heart—I cite this in my testimony, quotes from various reports—at the heart of the reports is a similar type mechanism that would in effect create a process and an unusual broker in the Executive Office of the President that could in effect harmonize the objectives of the various agencies and functions that have an impact upon American industrial competitiveness here and abroad.

Your bill, I think, is an important step in that process. I think it sets up a mechanism and device that would permit business, Government, labor, and interested citizens to access that process.

I think it is also an important bill in the fact that it is to my knowledge the only piece of legislation at this point that is taking on this specific issue of coherence of the Federal interventions that affect American industrial competitiveness.

In my own mind, specific features of the bill such as whether there should be 12 or 20 members or whether it should be housed here or there or how many staff people it might have and whether it issues one report a year or two reports a year, they are very secondary issues.

The heart of the bill—which is to bring focus to these interventions create a mechanism by which businesses, labor, other units of Government, citizens, can access the Federal Government and bring to bear their perceptions of how individual actions are affecting their competitiveness and to speak to duplications and unintended consequences—is immensely important and, I think, truly one of the primary beneficiaries of this will be the President and the Congress, because it seems to me the central issue you are facing and addressing is not the question of Government managing business, but the question of Government managing Government.

It seems to me at least that our processes of public administration are to the point where we badly need something such as your proposal.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Choate follows:]

STATEMENT OF PAT CHOATE, DIRECTOR OF POLICY ANALYSIS, TRW INC.

Mr. Chairman and Members of the Committee:

I am pleased to have this opportunity to share with you my thoughts on H.R. 2373 and the important national problem it addresses: namely, the management of government's many interventions into the economy. And in fairness to you and my employer, TRW Inc. I do wish to emphasize that the views I bring this morning do not necessarily reflect any opinion or position other than my own.

As previous hearings before this Committee have highlighted, the decisions of American government influence the economy in many ways. An article in the January 1985 *Harvard Business Review* estimated that half of all actions taken by business are in direct response to the decisions of government. The techniques of public administration have not kept pace with this reality.

By design our system of government splinters power. As you know, authority in Congress is divided among 8 select and special committees, 38 full committees and 242 subcommittees. The splintering of power in Congress parallels a similar fragmentation in the executive branch. Since the New Deal, dozens of new agencies and programs have been created, often with little regard to what already existed. Power in the executive branch is now atomized among 8 major offices within the Executive Office of the President, including the Office of Management and Budget; 13 departments, 55 independent agencies and government corporations and hundreds of individual programs.

Of course, most major decisions in government require action by both the executive and legislative branches. The likelihood of securing agreement in this environment of fractured accountability is slim. Modifications in federal pension policies, for instance, involve 10 cabinet departments, 25 operating groups within these departments, and 119 congressional committees and subcommittees. Shifts in economic policymaking implicate 33 separate agencies and departments outside the White House.

Decisions about U.S. trade policies are divided among the United States Trade Representative, the Office of Management and Budget, the Council of Economic Advisers, the Secretary of Commerce, at least 25 other departments and agencies in the executive branch and 19 committees and subcommittees of the Congress.

The complex, fragmented structure of the federal system protects each of us against tyranny. But it also slows decisionmaking and diminishes government's ability to address issues, even those that are crucial to our national well-being such as declining U.S. competitiveness.

The gridlock, duplication, delays, omissions and unintended consequences that now impede government and harm our nation's competitiveness cannot be altered by simplistic nostrums such as eliminating government, centralizing power, or abdicating public responsibilities. Massive government reorganization is yet another sterile approach to improving policymaking or programs.

Moreover, reorganization is typically a waste of time, a source of delay and a poor substitute for substantive action. Since 1948 there have been 29 major, but unsuccessful, attempts to restructure and consolidate federal economic policymaking in the executive branch: such authority is now delegated to 33 separate departments and agencies outside the White House.

Techniques of politics and governance that will permit flexible, speedy decisionmaking and simultaneously preserve open and democratic government are the most practical means of improving government decisionmaking. Fortunately, there is great latitude for innovative policymaking and better management in the complex system of American government.

President Ronald Reagan, for example, has imaginatively broken several major political gridlocks by appointing bipartisan commissions that worked outside the formal structure of government to devise proposals which are then brought to the President and Congress for ratification. Bipartisan commissions helped break the political impasse on sensitive issues such as Social Security reform, deployment of the MX missile and the Caribbean Basin Initiative.

Governors, local officials and citizens are also creating public policies and political solutions outside the normal political processes. Referenda that permit policymaking through the ballot box are one such technique. Among the first and certainly best known of these referenda was California's tax-cutting Proposition 13 in 1978. More than 300 state initiatives were considered in the 1984 elections. Many were far-reaching: 33 attempted to change state tax structures, 17 were designed to limit and alter the power of state legislatures, and 46 sought to change laws on social issues such as abortion and interracial marriage.

While special commissions and public referenda are important policymaking tools, they often take months, even years to effect change. They are plainly inappropriate for decisions that must be made with flexibility and speed, such as those concerning the money supply or international trade agreements.

In many such circumstances, the cabinet council approach may be an effective response. During his first term, President Reagan resolved many policy differences through seven cabinet councils, each of which had primary responsibility for a different policy area—commerce and trade; economic affairs; food and agriculture; human resources; legal policy; management and administration; and natural resources and the environment.

Each was composed of cabinet officers, had professional staff support and was chaired by a department head; the Secretary of Agriculture, for example, chaired the council on food and agriculture. In 1985, executive decisionmaking was further streamlined when these seven councils were consolidated into two—a domestic policy council chaired by the Attorney General and an economic policy council headed by the Secretary of the Treasury.

Although the cabinet council approach has advantages, it also has major flaws. Agency heads, for instance, are notorious for their refusal to defer to peers, even one appointed by the President as chairman of a council. Moreover, most issues, such as trade, involve the reconciliation of multiple social, economic, defense and foreign policy issues which transcend the scope of an individual council. If flexible, timely and focused decisionmaking is to become a regular feature of government, other techniques of governance are also required.

This need has not gone unnoticed. As I reported to you last year, since 1983 there have been dozens of studies on long-term competitiveness and the need to improve the quality and focus of government decisionmaking. I analyzed 17 of those studies. They included leaders from virtually all of the leading companies (large and small), unions, academe, public policy institutes and foundations, along with hundreds of citizens.

A common feature among several of those studies was the need to improve the coherence of government decisionmaking, regardless of whether the size and influence for government is larger or smaller. Several of these studies also came to the conclusion that while some reorganization of government may be warranted, what was most important was to create a decisionmaking process at the highest level of government that would assure that issues that affect the long-term competitiveness of American business and workers were given the attention and priority they require.

The Business-Higher Education Forum, an organizaton of leading college presidents and business CEO's called for the creation of a Presidential Adviser on Economic Competitiveness. The task of this adviser would be to "help the President and other policy-makers focus on the diverse concerns—such as trade and investment regulatory reform, technological innovation, and the development of human resources—basic to an effective competition effort."

The President's Commission on Industrial Competitiveness, the Young Commisson, noted that "Government decisionmaking can be strengthened significantly by providing a forum in which consensus can be reached on the facts of an issue and in which the implicit tradeoffs among policy options can be made explicit. In addition, the President would be well served by the creation of a small staff in the Executive Office of the President to study and advise him on competitiveness."

The Center for National Policy—in a study led by Felix Rohatyn, Lane Kirkland and Irving S. Shapiro—reported that a missing ingredient in America's competitive efforts is "an effective process for making policy decisions." They called for "An Industrial Development Board, composed of government, labor and business leaders, to advise the President and develop cooperative strategies to promote industrial growth . . . and help insure that government efforts do not work at cross-purposes with private efforts."

The Committee on the Next Agenda—a Committee convened by the Administration and composed of leaders from the Brookings Institution, the Heritage Foundation, the Hoover Institution, the Hudson Institute, the American Enterprise Institute, the Institute on Research of Economics of Taxation—informed the President that "There is an overriding need for a clearly developed and articulated comprehensive foreign economic and trade policy . . . The current fragmented system to be rationalized or replaced by mechanisms that promote the formulation of coherent, long-term and thoughtful approaches to foreign economic and trade issues."

The Committee on the Next Agenda also noted a parellel that I think interesting: namely, that the nation has long considered ad hoc approaches to national defense issues as being totally unacceptable. Accordingly, since the late 1940s a succession of

Presidents have had National Security Advisers whose role is to coordinate the many diverse actions of agencies that affect our long-term strategic well-being, such as the Departments of Defense and State and the Central Intelligence Agency, among others.

Noting this parallel, they recommended that "a broker is needed within the Executive Office of the President to reconcile, overlapping defense, foreign, economic and trade areas. The broker role would play an important coordination function in the government, not a planning function. It should provide for the institutionalization of an economic policy apparatus that integrates domestic and international considerations, eliminates redundancies, and has sufficient authority to do the job."

The message that is being sent to the Congress and the President by distinguished leaders from business, government, unions and academe is that government must give much more attention to the management of its affairs and how those affairs affect the competitiveness of our nation's economy. The legislation you are considering, H.R. 2373, is an important step in that process. It provides high level oversight and the mechanisms that are required to collect and anlayze information, secure a broad, open consideration of views and translate analysis into specific policy recommendations for the President and Congress.

Whether the corrdination mechanism you call for has 10 or 30 staff professionals, has 10 or 30 members on the counsel or is required to report annually or semi-annually are secondary considerations. What is important is that your legislation would elevate the issue of trade and competitiveness to a parity with foreign policy and national defense. That has long been needed.

Equally important, your proposal would begin the long overdue process of improving the coherence of federal decisionmaking, particularly as it influences the competitiveness of U.S. industries. That too has long been needed.

In sum, I applaud the time and attention this Committee has devoted to this most important subject. The legislation you propose will be central to any larger national effort to improve the U.S. trade position and reverse the competitive decline now faced by American industry. I hope this legislation can receive full consideration in this session of the Congress.

Thank you.

Chairman LAFALCE. Thank you very much, Mr. Choate. It is my understanding that you have some time constraint. What time do you have to leave?

Mr. CHOATE. I have to leave at 11:15 a.m.

Chairman LAFALCE. All right.

Having heard from the business community, TRW, I will take that as businesses across-the-board perspective on this legislation, I will go to a spokesman for labor. Mr. Henry Schechter, of the AFL-CIO.

STATEMENT OF HENRY B. SCHECHTER, DEPUTY DIRECTOR, ECONOMIC RESEARCH DEPARTMENT, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

Mr. SCHECHTER. Mr. Chairman, members of the committee, I appreciate the opportunity to present before you the views of the AFL-CIO on the Council of Industrial Competitiveness Act.

Mr. Chairman, you deserve the applause of American labor and industry for your continued efforts to formulate and obtain enactment of legislation creating a council that would help restore the competitiveness of American industry. In the 3 years since we testified before your committee in favor of such a council, events have substantiated and increased the need for it.

The U.S. merchandise trade deficit, which was $42.7 billion in 1982, mounted in succeeding years to $69.4 billion, $123.3 billion, and $148.5 billion in 1985. The first 1986 monthly figure shows a continuation of this uptrend.

Chairman LAFALCE. If I could interrupt you, Mr. Schechter, I think you first testified in the spring of 1983 when we dealt with the 1982 figures which were about $42 billion as you say, and anybody who wanted to look at what was going on should have been able to realize that we were looking at $150 billion in trade deficits, and anybody who wants to look now should realize that even though the dollar has dropped we are still going to have fantastic trade deficits on our hands.

That is just a portion of the problem. Just a portion.

Please proceed.

Mr. SCHECHTER. The first 1986 monthly figures show continuation of the uptrend.

Furthermore, there has been no reversal of the accompanying secular uptrend in unemployment rates from peak-to-peak and trough-to-trough of successive cycles. While the civilian unemployment rate came down from the December 1982 peak of 10.7 to 6.7 percent in January of this year, the latter low point is still significantly above the previous cyclical low point of 5.6 percent in May 1979. Currently, the civilian unemployment rate is 7.3 percent.

Apparently, the past 5 years have not proven to be the adjustment period that so many proponents of hands off or laissez-faire policies toward international trade clalimed we were going through. Other nations who are our trading partners have not removed many unfair trade barriers; those with low-income populations have not developed higher income markets to facilitate balanced trade. Nor do we have faith that the recent 22-percent trade-weighted dollar devaluation—over the past year—relative to other major currencies will be enough to restore American producers to a competitive position that will enable them to recapture their markets.

Over the past few years, more and more advanced technology has been transferred from the United States to many developing as well as developed countries. The more advanced of these countries have helped their producers compete more effectively with a wide range of aids. They have provided low-cost credit for exporters and protective barriers for their producers against competition from imports.

There has been Government assistance in application of technology and production, and in financial planning. These advantages are used to achieve and maintain optimum economies of scale in production, so that low per unit costs and prices can be used to capture increased shares of world markets for the product lines involved.

There is a need for us to identify, analyze, and devise remedies for various types of competition. Where American producers are being outpaced because they are at a technological disadvantage, the competitive alternatives that are available must be weighed. Toward this end, all of our diverse talents can and should be pooled for such efforts through a council with representatives of labor, industry, Government, academia, and the public, such as proposed in your bill.

The Council should also investigate unfair trade barriers faced by different industries and bring them to the attention of the appropriate Government agencies.

An increasingly widespread problem is production in very low-wage countries which competes with the production in the United States for market shares in the United States and abroad. There are numerous developing countries in which wages are one-fifth or less and even one-tenth or less than wages for comparable work in the United States. Furthermore, the most advanced manufacturing technology has been transferred to some of these countries; and there is no reasonable hope of achieving successful U.S. competition in such areas.

It is not just across the Mexican border; in the Caribbean and Brazil; in China and Poland and Yugoslavia; in Korea, Taiwan, Hong Kong, and Singapore; but also in Sri Lanka, the Maldive Islands, and Mauritius in the Indian Ocean; and numerous other places.

In some product lines, furthermore, production from such sources has overwhelmed competing U.S. industries and captured a large part and in some cases, almost all of the domestic U.S. market, as well as part or all of U.S. producers' shares of overseas markets. The end result is sustained or increased high U.S. unemployment and a contracting U.S. market for many goods and services.

This ultimately must backfire upon the new producers and their national economies, as was illustrated in 1981–1982. Although this would be another area in which an industrial council could work to find remedies, we do not have the luxury of much time with regard to such developments.

The injury that has been suffered by many of our industrial sectors adversely affects livelihoods of large numbers of people in those sectors. The security and livelihoods of many are being destroyed. Quick action is needed. For that reason, we would urge that pending bills that deal solely with trade should be allowed to proceed independently through the Congress, and the Council on Industrial Competitiveness legislation should proceed as a separate matter.

A National Council on Industrial Competitiveness, including the various sectors of our society that have been mentioned, could identify industries that are vital to national economic growth and unemployment. Such a National Council could also study how the competitive conditions of American industries are affected by various economic and trade policies of the Government, and how they could be made more competitive.

It would also be helpful in restoring American competitiveness if the Council could consult with appropriate agencies of the Government in matters of trade regulation and economic policy that would affect the viability of industrial revitalization and growth plans that it supports.

In that connection, consideration might be given to authorizing the Council to intervene or participate on its own behalf in rulemaking, licensing, or other procedures of departments and agencies of the Government.

The latter function has great significance for the success of an industrial policy. The goal of the proposed legislation will be to provide help to lagging sectors of American industry in catching up with international competitors. However, they would not be able to

withstand the determined onslaughts of unfair trade practices by other nations.

It is appropriate, therefore, that the Council should have standing to present before agencies the case for correcting flagrant abuses of trade agreements and laws and safeguarding the gains made through the industrial policy program.

There should be authority for sectoral subcouncils, as your bill would provide, to help develop long-term development strategies and make recommendations to the National Council. Such sectoral subcouncils would have the most intimate knowledge of problem causes and be able to realistically appraise and recommend alternative remedies to improve competitiveness.

Another aspect in fashioning a successful industrial policy is the provision of adequate long-term financing, especially for companies developing new products and/or employing new technology. Patient capital is needed to permit an optimum production level to be maintained, even if there is some inventory accumulation in the first year or two, while sales volume is increased to match the optium production level.

That requires patient capital, and in some countries partial financing has been provided through a government entity, for example, the Japan Development Bank, to facilitate the attraction of long-term private capital for investment in new or modernizing enterprises.

It is recommended that in the formulation of legislation to establish a council to improve U.S. competitiveness, the National Council should be directed to formulate and recommend an appropriate financing mechanism to help attract private, long-term capital for new industrial production facilities.

The AFL–CIO favors the enactment of legislation to establish a Council on Industrial Competitiveness which could perform some of the functions that I have described.

I repeat that we would not want to see the trade bills possibly delayed if they were combined with the Council on Industrial Competitiveness, and we urge that they not be combined.

[The prepared statement of Mr. Schechter follows:]

STATEMENT OF HENRY B. SCHECHTER, DEPUTY DIRECTOR, ECONOMIC RESEARCH DEPARTMENT, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

I appreciate the opportunity to present before you the views of the AFL–CIO on the Council on Industrial Competitiveness Act.

You deserve the applause of American labor and industry for your continued efforts to formulate and obtain enactment of legislation creating a council that would help restore the competitiveness of American industry. In the three years since we testified before your committee in favor of such a council, events have substantiated and increased the need for it.

The United States' merchandise trade deficit, which was $42.7 billion in 1982, mounted in succeeding years to $69.4 billion, $123.3 billion, and $148.5 billion in 1985. The first 1986 monthly figure shows a continuation of this uptrend. Furthermore, there has been no reversal of the accompanying secular uptrend in unemployment rates from peak-to-peak and trough-to-trough of successive cycles. While the civilian unemployment rate came down from the December 1982 peak of 10.7 percent to 6.7 percent in January of this year, the latter low point is still significantly above the previous cyclical low point of 5.6 percent reached in May 1979. Currently, the unemployment rate is 7.3 percent.

Apparently, the past five years have not proven to be the adjustment period that so many proponents of "hands off" or "laissez-faire" policies toward international trade claimed we were going through. Other nations who are our trading partners have not removed many unfair trade barriers; those wtih low-income populations have not developed higher income markets to facilitate balanced trade. Nor do we have faith that the recent 22 percent trade-weighted dollar devaluation relative to other major currencies will be enough to restore American producers to a competitive position that will enable to recapture their market shares.

Over the past few years, more and more advanced technology has been transferred from the U.S. to many developing as well as developed countries. The more advanced of these countries have helped their producers compete more effectively with a wide range of aids. They have provided low-cost credit for exporters and protective barriers for their producers against competition from imports. There has been government assistance in application of technology and production, and in financial planning. These advantages are used to achieve and maintain optimum economies of scale in production, so that low per unit costs and prices can be used to capture increased shares of world markets for the product lines involved.

There is a need for us to identify, analyze, and devise remedies for various types of competition. Where American producers are being outpaced because they are at a technological disadvantage, the competitive alternatives that are available must be weighed. Toward this end, all of our diverse talents could and should be pooled for such efforts through a council with representatives of labor, industry, government, academia, and the public. The council should also investigate unfair trade barriers faced by different industries and bring them to the attention of the appropriate government agencies.

An increasingly widespread problem is production in very low-wage countries which competes with the production in the United States for market shares in the U.S. and abroad. There are numerous developing countries in which wages are one fifth or less and even one-tenth or less than wages for comparable work in the United States. Furthermore, the most advanced manufacturing technology has been transferred to some of these countries; and there is no reasonable hope of achieving successful U.S. competition in such cases. And the number of such foreign sources for parts and whole products is increasing. It is not just across the Mexican border; in the Caribbean and Brazil; in China and Poland and Yugoslavia; in Korea, Taiwan, Hong Kong, and Singapore; but also in Sri Lanka, the Maldive Islands and Mauritius in the Indian Ocean; and numerous other places.

In some product lines, furthermore, production from such sources has overwhelmed competing U.S. industries and captured a large part of the domestic United States market, as well as part or all of U.S. producers' shares of overseas markets. The end result is sustained or increased high U.S. unemployment and a contracting U.S. market for many goods and services. This ultimately must backfire upon the new producers and their national economies, as was illustrated in 1981–82. Although this would be another area in which an industrial council could work to find remedies, we do not have the luxury of much time with regard to such developments. The injury that has been suffered by many of our industrial sectors adversely affects the livelihoods of large numbers of people in those sectors. The security and livelihoods of many are being destroyed. Quick action is needed. For that reason, we would urge that pending bills that deal solely with trade should be allowed to proceed independently through the Congress, and the Council on Industrial Competitiveness legislation should proceed as a separate matter.

A National Council for Industrial Competitiveness—including representatives of labor, business, academia, the public, the government—could identify industries that are vital to national economic growth and employment. Such a National Council could also study how the competitive conditions of American industries are affected by various economic and trade policies of the government, and how they could be made more competitive. It would also be helpful in restoring American competitiveness if the Council could consult with appropriate agencies of the government in matters of trade regulation and economic policy that would affect the viability of industrial revitilization and growth plans that it supports. In that connection, consideration might be given to authorizing the Council to intervene or participate on its own behalf in rulemaking, licensing, or other procedures of departments and agencies of the government.

The latter function has great significance for the success of an industrial policy. The goal of the proposed legislation will be to provide help to lagging sectors of American industry in catching up with international competitors. However, they would not be able to withstand the determined onslaughts of unfair trade practices and protectionism by other nations. It is appropriate, therefore, that the Council

should have standing to present before agencies the case for correcting flagrant abuses of trade agreements and laws and safeguarding the gains made through the industrial policy program.

There should be authority for sectoral subcouncils, to be established by the National Council, to help develop long-term development strategies and make recommendations to the National Council. Such sectoral subcouncils would have the most intimate knowledge of problem causes and be able to realistically appraise and recommend alternative remedies to improve competitiveness.

Another aspect in fashioning a successful industrial policy is the provision of adequate long-term financing, especially for companies developing new products and/or employing new technology. Patient capital is needed to permit an optimum production level to be maintained, even if there is some inventory accumulation in the first year or two, while volume sales volume is increased to match the optimum production level. That requires patient capital, and in some countries partial financing has been provided through a government entity (e.g., the Japan Development Bank) to facilitate the attraction of long-term private capital for investment in new or modernizing enterprises. It is recommended that in the formulation of legislation to establish a council to improve U.S. competitiveness, the National Council should be directed to formulate and recommend an appropriate financing mechanism to help attract private, long-term capital for new industrial production facilities.

The AFL-CIO favors the enactment of legislation to establish a Council on Industrial Competitiveness which could perform some of the functions that I have described. In light of the need for rapid enactment of pending trade bills, and the fear that they would be delayed if they were combined with the Council on Industrial Competitiveness Act, we urge that they should not be combined.

Chairman LAFALCE. Thank you very much, Mr. Schecter. We are going to take a brief 10-minute recess so we will have the opportunity to vote.

I would make one brief comment. It is a political judgment as to how to best proceed—individually on the Council bill if that is the disposition of the subcommittee and the full Banking Committee; individually on the Competitive Exchange Rate Act which was reported out of the Subcommittee on International Monetary Policy; or as part of the trade bill.

I think it is necessary to distinguish between the Council on Industrial Competitiveness, which I always said is the centerpiece of industrial strategy, as opposed to any bank.

I think it was the bank that was the baggage in the past Congress. That doesn't detract at all from the intellectual perspective that you or I or others might have concerning the bank and its need, but coming to grips with the political reality that a bank would not fly, will not fly and that that was the excess baggage and that the Council, in my judgment, might well and should fly on its own—and given the tremendous backing, implicitly if not explicitly for the concept at least of so many diverse groups across the United States for a mechanism to make coherent our competitive strategies, it seems to me that it should get unanimous support.

Whether it will get the unanimous backing or not is debatable. But it should be.

We will take a 10-minute recess.

[Recess.]

Chairman LAFALCE. The subcommittee will reconvene.

Our next witness is Prof. Lester Thurow of MIT, and he is renowned for many things—his work at MIT, the books he's authored, and the fact he will be giving a speech at the University of Buffalo Friday in New York State, which I have the pleasure of representing.

Professor Thurow, you see all those things in the past diminish in comparison to your speech in western New York.

STATEMENT OF LESTER THUROW, SLOAN SCHOOL OF MANAGEMENT, MASSACHUSETTS INSTITUTE OF TECHNOLOGY

Mr. THUROW. There is still now on the ground out there, too.

Let me get to where you are going from a slightly different route.

What I would like to argue in this whole area is there should be a sense of urgency that isn't there. We talk about trade deficits and we tend to forget that a trade deficit is a mirror image of the foreign borrowing the United States has to have. In the United States, we are very rapidly going from being the world's largest net creditor nation in 1982 to sometime in the next month or two, the Government will announce we have become the world's largest net debtor nation. We are so used to thinking about Federal deficits the idea we have become a large debtor nation doesn't have any capacity to create a feeling of crisis in the United States, and I think it should because there is a great difference between Americans borrowing money from Americans to finance the Federal Government deficit and from Americans borrowing money from the rest of the world to finance its trade deficit. Let me see if I can make that clear.

If we borrow money from ourselves to finance the Federal Government deficit, we have not made the average American family income higher or lower because we, the taxpayers, owe the money and we, the bondholders, get the money, and so we reshuffled it slightly among Americans but we have not lowered or increased the average standard of living.

On the other hand, if we borrow from the rest of the world we have a set of consequences that when they come home, the average American family will find very disconcerting. At the moment with $149 billion trade deficit which is a little more than 3 percent of the GNP. That trade deficit and our ability to borrow the money to finance it basically means the average American family has a standard of living 3 percentage points above the standard of living it could have if we could not borrow money on the international money market.

At the same time, we build up very large international debts. If we are allowed to build up a debt to the level of $500 billion—we may well easily exceed that in the next few years—and assuming 8-percent interest rates, that would mean we would have to start paying the rest of the world $40 billion in annual interest or about 1 percent of our GNP.

When the day comes when we have to start paying that interest, we will lose the 3-percent addition to our standard of living we have gotten at the moment, and we will have that 1-percent subtraction from our standard of living, making a net fall in the average American living standards of about 4 percent.

Now, 4 percent may not sound like very much, but if you look at the largest reduction in the average American standard of living in the worst recession since World War II, it has only been 1½ percent. So, we are talking about something that the average Ameri-

can family will see as a reduction in their standard of living being three or four times as large as the largest negative item that has hit them in the last 50 years.

I don't think when that happens the average American family is going to regard that as trivial.

Now, it is important to understand that we are talking about two things here. If you talk about will that effect occur, we are not talking about economics, we are talking about simple arithmetic, and it will occur because no country can borrow money faster than its GNP is growing forever. At some point the rest of the world will want to be paid interest on those loans.

What nobody knows is how long can the borrowing occur.

Nobody knows because in some sense the United States today is skating on very new financial ice, and I would regard it as very thin. The world's wealthiest country has never before been the world's largest net debter. No country in human history plunged into debt at the rate the United States is now plunging into debt, and the world's reserve currency has never been held by a debtor nation in all human history.

Who would put your money in a bank that is broke or in debt, which is what the United States is at the moment.

Now, if you think about when the lending will stop, you can make a couple arguments and they lead to very different conclusions, not about will the lending stop, but when.

If you say we are the wealthiest country, the rest of the world may be able to lend us a lot of money. If they were willing to lend us $1,000 billion, then the borrowing could essentially go on until the early 1990's.

At that time, we would owe the rest of the world 2 percent of our GNP for the rest of the world forever. As the world's reserve currency, however, it means there are hundreds of billions of dollars held by people who never plan to come to the United States, have no interest in investing in the United States, and are only seeking safety.

That is a very nervous crowd. They could bail out on the dollar tomorrow morning. If you think of the difference between those two scenarios, tomorrow morning or 5 or 6 years from now, that is all the difference in the world, but even 5 or 6 years from now is not very long.

I would remind you of one further fact. If you think about Mexico, the interesting thing about the Mexican bankruptcy on August 13, 1982, is the world's financial markets gave not a scintilla of evidence they were about to quit lending before the lending stopped. On the morning of August 13, 1982, Mexico could not borrow a peso at any interest rates. In the days immediately preceding August 13, Mexico borrowed $1.5 billion at the standard interest rate without an interest in international capital markets that the lending was about to stop.

Now, there is one other moral of the story in the Mexican case. What is the conventional wisdom to say about Mexico today? The first conventional wisdom is to say they were foolish to mortgage their future and borrow that kind of money from the rest of the world.

The second conventional thing to say is the banks were foolish to lend them that kind of money and mortgage the banks' future.

I would be willing to bet that 5 to 10 years from now, we will be sitting here saying the United States was foolish to borrow the sums of money it has borrowed, the rest of the world was foolish to lend the United States the sums of money it was lent.

Then the question is if you think it is foolish for the United States to borrow the amount of money it is now borrowing, which is the same as saying it is foolish for it to run its current trade deficit, the question is how can you change that rapidly?

Here it is important to understand that although—I agree with the chairman—although a falling currency and falling value of the dollar is important, it is not the sole answer to the problem. If you make a calculation of how much would the yen have to fall to get a basic balance between the United States and Japan in their international accounts, in my calculations the yen would have to fall to about 100 yen to the $1, which is a long, long way from 175 yen to the $1, which is where it is today.

That will eventually happen. What the administration tends to forget is they have the general belief that markets take care of problems. That is certainly true, but what they tend to forget is that markets take care of problems in very brutal ways. The market took care of Mexico on August 13, 1982. It said we will not lend you any more money. Period.

If that were to happen in the United States tomorrow morning, the American standard of living as I said, would fall by 3 percentage points a day later—which the average American would regard as a crisis.

If you think about this problem, a lot of Americans talk about an unfair playing field. President Reagan in his State of the Union message said something which sounded very good as it rolled off his tongue, but just isn't true. You remember he said we can outsell, outmarket, and outproduce anybody else in the world if we have a level playing field. Now we cannot outsell, outmarket, and outproduce everybody else in the world, even if we have a level playing field, because there are some things we are going to have to do in the United States to change standard American operating procedures to be competitive in those world markets.

Last year, for example, the rate of growth of productivity in the rest of the industrial world averaged between 3 and 4 percent. The rate of growth of productivity in the United States in 1985 was negative. If American industry is going backward at a negative rate and foreign industry is going forward at a rate of 3 or 4 percent a year, then obviously American firms will not be competitive in the world markets under any circumstances.

Now, the problem with the level playing field that the President referred to is that what most Americans mean by a level playing field is an American playing field, and that the whole rest of the world agrees to trade by exactly the rules that Americans would like them to agree to.

The important thing to understand about the playing field is that there are no rules. It is not that the Japanese or Europeans are violating some international treaty and some set of rules.

We do not have a set of rules as to how we play the international game, because our set of rules is embodied in GATT and when that was set up in the 1950's, basically the only rules we specified were rules relative to tariffs and quotas.

We didn't have rules about competitiveness councils, government banks, a whole set of other issues which have become so important.

I think we have gotten to the point where we have to negotiate that set of rules more or less on an emergency basis. I think what that probably means instead of doing a very slow moving GATT, for example, we have to do a negotiation with our major trading partners to get some agreed upon set of rules which means Europe, Japan, and Canada, and we have to recognize that those rules will not be American rules.

We have socialist parties in the rest of the world, for example. They are not going to agree to any set of rules where governments have no role in their economies. We have ministries of industry and trade in the rest of the world. They will not agree to any set of rules where you don't have a ministry of industry and trade, because that is their standard operating procedure, and they may change some of their standard operating procedures, but we will have to change some of ours.

I think what that means when you get down to the subject of this hearing is if you look at what the rest of the world does, if you imagine negotiating those rules of what are the rules of the ball game, you will end up with something that may be called a ministry of industry and trade, a competitive council, call it many things, but you will have to have it.

If you refuse to have it, you simply won't be competitive in international trade. You can see that at the moment.

For some reasons that we might object to, back in the 1950's value-added taxes were made rebatable in international trade. It is the only VAT tax of all taxdom which is rebatable under international trade.

The United States is the only country in the world that doesn't have it. That is exactly like trying to compete in international trade with cutting off one of your arms, because the rest of the world has an immediate cost advantage because they have that tax and we don't. Who is at fault?

The rest of the world that takes advantage of international law, or the United States that likes to pretend international law doesn't exist, and that it is so powerful it doesn't have to take advantage of those loopholes in international law?

No; what I think that means is that if you think about a competitive council it obviously is not a short-run solution to the trade problem. I would argue we need short-run solutions to those trade problems, but if you look at the short-run solutions and negotiating a set of playing rules is an important part of them quickly, then that set of rules will make such a council legal, and once it is made legal then it will be like the value-added tax.

Are Americans smart enough to take advantage of it or do they refuse to use the instrument the way they refused to use the VAT? Americans' reluctance to do any strategic planning in international trade I find interesting, because it kind of flies in the face of part of our history.

Suppose that Ohio State would decide to play football with Michigan but decided to play without a coach and without a game plan? We would regard Ohio State as crazy. When it got beaten by Michigan, we wouldn't regard it as a surprise.

But we have the equivalent thing in international trade. We are playing a very competitive ball game, the rest of the world has a coach, sometimes it is in government as it is in Japan, sometimes in private industry, Deutch Bank as in Germany, but everybody has a coach and everybody has a game plan as to how they will conquer American markets and do it in a coordinated way.

If the United States refuses to have a game plan and refuses to have a coach, then I think the simple answer is no matter where the dollar falls we are simply going to be beaten.

Thank you.

[The prepared statement of Mr. Thurow follows:]

STATEMENT OF LESTER C. THUROW

Given the wisdon of hindsight what does everyone say about Mexico and the banks who lent to it? Mexico was foolish to mortgage its future by plunging into debt. Its lenders were foolish to mortgage their future by lending Mexico more than it could possibly repay.

As a country that is in the process of becoming the world's largest net debtor, the same wisdom of hindsight is relevant to the United States. Future economic historians will castigate the United States for allowing itself to shift from being the world's largest net creditor at the end of 1982 to being the world's largest net debtor early in 1986.

No country can forever go on violating what I call the first commandment of a Swiss banker—"Never lend money to anyone who must borrow money to pay interest!" While substantial uncertainty exists as to when the lenders will stop lending to the U.S. because they regard it as too risky to warrant further loans, there is no uncertainty that the foreign lending will stop. No country can forever borrow money at a rate faster than its GNP is growing for eventually interest payments on those outstanding loans grow beyond the ability of any country to repay. The United States is much larger and much wealthier than Mexico and can borrow much more than Mexico but it cannot repeal this fundamental arithmetic reality.

What happens when the foreign lending stops depends upon how soon the lending stops. If the lending should stop tomorrow morning, the United States would be forced to almost instantly eliminate its trade deficit. Since today's $149 billion trade deficit allows the United States to enjoy a consumption standard of living that is about 3 percent higher than its production standard of living, the average American consumption standard of living would have to fall about 3 percent when the $149 billion trade deficit were eliminated. In addition the United States would have to begin paying interest on its accumulated outstanding international debts—about $100 billion. With an 8 percent interest rate this would involve giving $8 billion in goods and services to the rest of the world as interest payments on outstanding loans.

If Americans continue borrowing until they have accumulated $500 billion in net external debt, then with an 8 percent interest rate the United States will forever have to pay the rest of the world $32 billion (about 1 percent of the GNP) in annual interest payments and its own consumption standard of living will permanently have to be $32 billion below its own production standard of living.

Realistically no one can say how long the foreign lending will last. The world is simply skating on brand new financial ice. The world's wealthiest country has never been the world's largest debtor. The world has never seen a country plunging into debt as fast as the United States. The world's reserve currency has never been held by a debtor nation.

As the world's wealthiest nation the U.S. may be able to borrow unheard of sums of money before the rest of the world gets nervous about our ability to repay in dollars of comparable value. Alternatively as the world's reserve currency, millions of holders of dollars seeking safety may bail out of dollars at a level of debt to GNP much smaller than that of Mexico when the banks bailed out on it.

It is also well to remember that in the Mexican case, the world's financial markets gave no hint that the end was near on August 13, 1982. On that day no one in

the world would lend money to Mexico at any interest rate but in the days immediately preceding August 13, Mexico was able to borrow in the international capital markets at the standard interest rate. Similarly there will be little or no advance warning in world capital markets that the rest of the world has lost confidence in the U.S. and views it as a debtor able to repay what it has already borrowed.

The United States must quickly do something to bring its foreign borrowing (and its mirror image the trade deficit) under control. Not to do so is to be foolish.

The dollar is currently falling in international exchange markets and this trend can only be encouraged. But it is important to understand that the dollar has a long way to go before it reaches a level where the United States is balancing its current accounts. In the late 1970's the yen stood at 180 to the dollar and in the early 1980's both Japan and the United States had an approximate balance in their balance of payments although the United States had a bilateral deficit with Japan. But since that time Japan has had 40 percent less inflation than the United States and its industrial productivity has grown 13 percent more. This means that to restore the relative production costs that existed in the late 1970's would require an additional 53 percent appreciation in the value of the yen—to a level of less than 100 yen per dollar. The yen is currently about 175 yen to the dollar and has a long way to go before such an equilibrium is reached.

Above and beyond a falling exchange rate, what should be done? Americans often talk about a level playing field, but the problem is not an unlevel playing field. It is an agreed upon set of trading rules that specify how the international trading game is to be played. The current GATT simply does not contain the rules of the game. Where can government aid be given; what constitutes dumping; what is a legitimate health and safety regulation; what actions can be taken to eliminate trade deficits and what actions must be taken to eliminate trade surpluses? These and many other questions are left unanswered. And being unanswered, each country in the world can feel that other countries are being unfair.

The upcoming GATT negotiations should be treated as emergency negotiations and not the very slow moving process that they now are.

But it should also be understood that this new set of competitive rules cannot be simply the rules that the United States would like to play by. It will have to involve some of the rules, such as heavy government involvement in banking and strategic planning, that are common among many of our trading partners. In the aftermath of World War II the content of the first GATT could be dictated by an economically dominant United States, but the days of American economic dictation are over and a new GATT will involve some competitive rules that Americans find strange or foreign—rules that will require changes in long-held standard American operating procedures.

Once such rules are in place it would be possible to say what changes Americans will have to make in their traditional economic operating procedures.

In the meantime two sets of actions or inactions should be taken. The U.S. Congress should resist any product by product retreat into protectionism. Such product by product restrictions make no sense economically and America cannot politically afford to fight with its allies over the importation of each and every product made by human beings.

It should, however, adopt some form of what I have called "general reciprocity" to speed up negotiated changes in the rules of GATT. I would suggest that any country with a large world-wide balance of payments surplus and a bilateral surplus vis-a-vis the United States should be required to make rapid numerical progress at reducing its overall surplus. If this progress were not being made, the country could be required to bid to obtain import licenses to sell its products in the U.S. market and these import licenses would only be issued in quantities consistent with the U.S. making rapid progress in reducing its trade defict.

As the world economy is now structured there is no pressure on surplus countries to reduce their surpluses. The U.S. cannot dictate to the rest of the world, but it can create a real pressure to quickly negotiate a common set of rules.

Chairman LAFALCE. Thank you for that stark realistic appraisal, Professor Thurow.

We have had a couple of phenomena. Our unemployment has come down from the almost historic highs circa 1982 beginning in 1983, although it is still higher than it was before the recession, and the most recent month saw a spurt upward again of about four-tenths in 1 month, as I recall it.

I hope that is only a monthly aberration. Do you think one of the reasons our unemployment is where it is rather than being considerably higher is because our productivity has gone down? That is just a——

Mr. THUROW. There is no question that to some extent high productivity and slower employment are mirror images of each other. Suppose productivity went down 4 percent every year, then you would need 4 percent more workers every year just to produce the old output. In that narrow sense, it is a positive. But the real way you want to get employment up is to have an expanding economy and high productivity growth, because if productivity doesn't go up then the average American cannot have an increase in their real income.

Chairman LAFALCE. We always take solace in the fact that unemployment is 7 percent—they think that is low, I think it is high—isn't that 7 percent a false figure because of the fact that we have had very poor productivity rates over the past 2 years or so?

Mr. SCHECHTER. I would like to mention another factor which I think has come into play in getting us to high unemployment rates. We have less of a balanced economy and that has been happening for some time. First, even our own income distribution began to be skewed toward the top. Since the mid-1960's, we get more concentration at the top.

Then we get into the international economy to a greater extent and we are playing with an even more skewed income distribution, because we have the great difference between the production costs and the selling prices really, which are taken by higher income groups, either by producers in countries of production, and of course by the transportation, for distribution and so on.

So we suffer from unemployment because we have lost markets increasingly, and it becomes increasingly difficult to adjust toward a lower-unemployment rate because we have lost this sense of economic balance.

In the past when we had increasing productivity there was a better distribution of the increased product and income. Now we have gone more to services which provides for first of all lower productivity and second, the income distribution isn't as balanced as it used to be.

Chairman LAFALCE. Professor Thurow, in your written comments—I don't think in your oral presentation—you expanded upon your concern that despite the fact that the yen to the dollar is now approximately 175 or 180, that that doesn't bring us to the same competitive level we were with the Japanese.

You mentioned the inflation, productivity, et cetera. Could you expand on that?

Mr. THUROW. Sure. There are a couple ways you get to the 100 yen to the dollar figure. If you go back to the late 1970's it was basically 180 yen to the dollar and remember, that where the currency is has a value on what the economies look like a year or two later.

If you look at the American and Japanese economies in 1980–81, we had a bilateral deficit with Japan but both sets of accounts had surpluses with other people. Both sets were in balance here and in Japan. The yen was at approximately 180.

That is equilibrium in economist terms. Going back to 180 after going to 280 doesn't return to equilibrium. In the intervening time, we have had 40 percent more inflation and they have had 13 percent more growth in productivity.

If you put those two things together, more inflation here and more productivity there, it basically means you would have to have another 53-percent increase in the value of the yen or decrease in the dollar from that 180 level just to get back to the production costs that existed in 1980–81. That means a yen of a little less than 100 to the dollar.

The other way you can come up with the same number is you can ask yourself in the long-run equilibrium, at the moment the United States is a debtor Nation. That means we have to start paying interest on the debts and, at the moment, we have $100 billion of debt and with 8 percent we will owe the rest of the world $8 billion.

The Japanese have about $100 billion surplus, the largest net creditor nation in the world, and with net assets of $100 billion it means the rest of the world will be paying them $8 billion a year. It means that they have to have a trade deficit and we have to have a trade surplus.

You can calculate how much would our currency have to fall to get us a trade surplus, how much would their currency have to rise to get them a deficit and if you grind that through your favorite econometric equation, you will come up with a number something like 100 yen to the dollar.

One of the things Congress has to be sure about when Mr. Volcker talked about not wanting to see the yen rise further or the dollar fall further, that we just have to have it. One hundred eighty yen to the dollar won't do it if you want 2 years for the effects to show up.

You will need a much bigger change than to get American industry back onto that level playing field in terms of currency values.

Once they are there, American industry will have to respond by having equal productivity growth because if you believe in a private economy, we basically delegated to private industry responsibility for having a competitive rate of growth of productivity. In some sense private industry isn't living up to their responsibilities at the moment. They are not delivering what they are supposed to be delivering to the American public, more efficiency year after year.

If you think about it last year it is devastating. Technically speaking, at the end of 1985 the average American business firm was a little stupider than they were at the beginning of 1985, because their efficiency had gone down over the course of the year. You know, that has never happened I don't think in the United States except in recessionary periods, where it happens because of shifts in overhead labor.

It just is a dismal performance on the part of American industry. While we occasionally castigate Washington, DC, this is one area where industry ought to be thoroughly castigated.

Chairman LAFALCE. We might have had a small negative period in 1980 by a small percentage of 1 percent, but I don't recall 3- to 4-percent negative.

Mr. THUROW. Not 3 to 4. Just slightly.

Mr. SCHECHTER. Only the last quarter.

Mr. THUROW. This is the first year we have not had a recession when we have had negative productivity. What happens when you have a recession you lay off, you don't lay off overhead as fast as output falls, so productivity is going down in the recession—but last year wasn't a recession.

It was in the midst of what President Reagan likes to think of as a boom prosperous period, and to have negative productivity in the middle of prosperity is a dismal comment on the system.

Mr. CHOATE. Let me elaborate on some of those comments.

Of course declining productivity is a surrogate for a failure in a variety of policies that deal with capital investment, formation of new technologies and it is, both public and private, adequate training in the workforce, a variety of efforts.

What the declining productivity suggests to us as we look over the past 20 years, we have been deficient as a country in many of these individual areas for a long period of time.

Declining competitiveness is a surrogate that indicates not only failure of our productivity growth to maintain the levels that we need to meet the aspirations that we have as a society, as a country it also reflects the failure of our trade policies, reflects a failure of our macropolicies, reflects weaknesses in our policies on international exchange rates.

In other words, it, too, is a surrogate for many individual areas. What we lack most importantly, I believe, are the necessary forums where these interconnections, linkages between these failures, where small failures in capital markets or in technology or worker training can be related to the larger failures that exist and to the diverse array of interventions that are required on the public sector and the many actions that will be required upon the part of private sector workers, unions, and others.

In other words, we don't have a mechanism by which we can forge the strategic vision and identify the linkages and translate vision into specific actions that can be implemented. That is why I think this particular bill is important.

Chairman LAFALCE. Ergo a mechanism to come up with a Council—the Council is the mechanism. Virtually every group that has studied the issue—business, labor, academia—has said we need a mechanism.

Do you know of any group that studied the problem of competitiveness and suggested we didn't need some mechanism to coordinate our strategies, Professor Choate?

Mr. CHOATE. In the 17 studies I have looked at and several others since then, I have not been aware of any.

Mr. THUROW. Let me tell a story about a foreign game plan which I think, illustrates the problem.

Let's look at the strategy of the Japanese to conquer the semiconductor industry in the United States, which was 92 percent United States and 8 percent Japanese.

If you have been reading the business pages in the last 2 or 3 months, they have been writing obituaries for the American semiconductor industry.

Chairman LAFALCE. Which is not even smokestack America.

Mr. THUROW. Exactly. I want to say none of the things I will mention are illegal under any treaty we or the Japanese have ever signed. They had a perfect right to do every one of these things I am now going to mention.

Chairman LAFALCE. Therefore they are not unfair, either. You can have free, but not fair trade.

Mr. THUROW. They are not unfair. They wanted to make that industry their industry. If you go back to the 8K ram, that was an American industry. They wanted a piece of the action and what they did was a number of things. They first more or less annointed five firms that were allowed to go into the semiconductor business. It just happens the five are the big consumer electronics companies which meant they had a captive market because they owned the world market for consumer electronics.

No other firm was allowed to go in the business in Japan. The Government put a large amount of money, matched by private money, into what was called their very large integrated circuit chip program, research and development essentially designed to skip the 16K ram chip and jump immediately to the 64K ram chip, so they would leapfrog American technology because the American firms were developing at the 16K ram and they would jump to 64 and get there ahead of the Americans.

The next thing they did because they wanted to expand this industry rapidly but, of course, it wasn't making any profit because the Americans owned the market, the Japanese Development Bank loaned the money to build the production facilities before they had the market, so the facilities could be built and financed without any hard evidence you could really beat the Americans in terms of getting a large share of this market.

Then Texas Instruments comes to Japan and Texas Instruments wants to have a 100-percent-owned subsidiary in Japan. That is again Japanese law, their perfect right to have the law. But like everything in Japan, it is negotiable. So the Japanese said if you want a 100-percent owned subsidiary, we will give you that if you license and cross license all the chipmaking technology to all these five firms in Japan. Texas Instruments says yes, which is their right.

Then the Japanese needed certain pieces of knowledge. If you go out to Silicon Valley you find many of the entrepreneural firms are grossly undercapitalized and desperately need money. If some big Japanese firms comes in and said we want to buy this patent right, you usually find they are willing to sell out cheap because they so desperately need money.

You put that package together and by the time you get to 256K ram, it is a 92 percent Japanese market and American companies have 8 percent of the market.

That is a good example of coaching plus game plan equals success. The American industry, I have nothing against entrepreneurs, they do lots of good things in America, but an economy made of loan rankers, talented individuals will not win any more than an Ohio State with talented individuals with no game plan and no coaching is going to win.

It is those things, it is just not that you have to have a response, where you decide to attack in semiconductors, there are markets

out there we ought to seek to conquer in the rest of the world in exactly the same sense that they have had a definite plan for conquering that market in the United States.

Chairman LAFALCE. Mr. Torres.

Mr. TORRES. Well, it has been a shot in the arm to listen to these three gentlemen this morning. Your responses to the proposed legislation have been most informative.

I would like to ask Professor Thurow, in your statement where you talk about changing the rules——

Mr. THUROW. I am saying we need some rules, we are not changing the rules. The rules don't exist.

Mr. TORRES. But in terms of these rules that we have to apply, it would mean heavy Government involvement and banking and strategic planning.

You have already said in your statement that this is common among our many trading partners at this time.

We all recall that after World War II there was a gathering at Bretton Woods that set the stage for rules in terms of monetary policy, that is, exchange rates, et cetera, et cetera, vis-a-vis our allies.

There appears now to be a great disparity given your statement between the ratio of dollar versus the yen. In other words, the rules are no longer relevant as you have also stated. Does this mean that perhaps we ought to be revisiting Bretton Woods to try to level out the playing field?

Mr. THUROW. I think that is right on target. I would argue that the decade between 1945 and 1955 was the decade of institution building, roadbuilding, rule building. We built a GATT, the IMF, World Bank, OECD, a whole set of economic institutions that have served the world well, but we have outgrown them. It is like moving from horse and buggy to automobile.

You have a set of roads and rules relevant to horse and buggies, but you invent the auto and you need new rules and new roads. In Massachusetts there was a law when you drove a car at night somebody with a lantern had to walk in front of you for safety reasons.

That vitiates the usefulness of a car. You need a law that says cars have to have headlights, and you have to have roads that are lit and so forth and so on.

If you look at General Agreement on Tariffs and Trade, it just doesn't talk about most of the things that are in the market today. It talks about tariffs and quotas. It doesn't talk about how a private steel company competes with a nationalized steel company. Some will have government assistance. That is their right. If British steel gets a one-fifth of their revenue from the taxpayer, do the others have a right to put on a 20-percent tariff? What are the rules?

I don't care what the rules are, we have to know what they are though. What about heavy civilian involvement in R&D. The Japanese do it. They say the Government doesn't spend more on R&D, yours happens to put it in defense. Of course that is true.

What are the rules in terms of how much and under what circumstances can governments get involved in civilian R&D? What are the rules about what government development banks like the

Japanese Development Bank does in terms of financing facilities that perhaps a private banker would not finance? There are a whole set of rules that you are going to have to have in order to make the world economy work.

So I do think we need another decade of essentially rulemaking and roadbuilding for the current modern economy, but the real obstacle to that is in the United States. The obstacle in the United States is twofold, first of all, the President of the United States thinks you don't need rules because you just let private markets do their thing and they will iron out. Second, we in the United States are not willing to change any set of rules. Some would be American, some would be foreign rules, and we are not willing to change our operating procedures to live by those foreign rules like the value-added tax indicates.

We could have done that any time in the last 25 years. Any time we would have done it in that time, American exports would have gone up and imports down. But for 25 years we refused to do it.

Mr. TORRES. Further, Mr. Thurow, do you agree with Mr. Choate and his analogous situation that we need at the Presidential level a sort of national security council in terms of this, the kind of legislation proposed?

Mr. THUROW. I think absolutely, partly because the negotiations also get tangled up in foreign affairs. One of the problems the administration has is the trade negotiators say we will get tough with the Germans, and the Secretaries of State and Defense for foreign policy reasons will say no, you won't. So the American Government, at the very least, has to be able to sort out its foreign policy things on an equivalent basis and economic things.

One of the real problems here, and they use to joke with Henry Kissinger, about the economics, is Henry would trade off any economic gain no matter how big for any political gain no matter how small, because he just wasn't interested in economics, he was interested in foreign policy, military-type things.

I think that is a major weakness in American Government. The economic people in the international area just don't have the clout with the political people in the international area, and what it means is that we are never effective international economic negotiators.

Chairman LAFALCE. And the Council of Economic Advisers is No. 1 almost exclusively macroeconomic in perspective; and B, I think they have gone into hiding.

Mr. THUROW. They are also a domestic agency. If the Federal Government had kind of a cabinet or subcabinet level of people on international trade they wouldn't even be there. It is not in their—it should be in their jurisdiction but it is not the way the system has been set up.

Mr. TORRES. I now have two opinions, I would ask a third opinion of my good labor brother, does he concur with the other two?

Mr. SCHECHTER. Yes, we certainly endorse a Council being created. We have supported that sort of thing for a number of years.

Mr. TORRES. And you would also see the great value in having this at the executive level.

Mr. SCHECHTER. Yes, otherwise it doesn't have much weight, it cannot accomplish much. Yes, we would like to see it at a high level in the executive branch.

Mr. TORRES. Thank you very much, all the three of you.

Mr. Chairman, I yield the balance of my time if I have any.

Chairman LAFALCE. You can take as much time as you like here.

Mr. TORRES. That is fine, thank you.

Chairman LAFALCE. Just a few more questions, not even related to the Council because all of you have been extremely supportive of the bill before us, and, as you say, you don't know of anybody who has studied the issue who is opposed to creation of a mechanism to deal with that problem.

Mr. THUROW. You have to be a little careful, the President's Commission on Industrial Competitiveness suggested it but the President rejected it. So we know one person who quasi-stated it.

Chairman LAFALCE. I say ". . . who studied it." The President has not studied it. The Commission did.

Mr. CHOATE. I would just like to make one elaboration. This is on an issue of will such a Council mean more Government involvement which was the point raised.

I think in many cases it will mean less Government involvement, because in many cases, I think, what will be found as we take a look at the interventions of Government, regulatory activities, is that what will be required to compete will be perhaps less Government intervention. What is now lacking is a mechanism by which those proposals can be put on the table as the type of proposals that Professor Thurow has indicated are necessary to devise a strategy.

So the formation of the Council in itself per se does not mean more or less Government intervention. What it means is that for the first time, we will have a mechanism by which Government can manage Government.

Chairman LAFALCE. That is a very good point.

I would ask a few other questions before we conclude.

Why do you think the dollar has fallen to the extent it has? First of all, it was around 260 or 270 yen in February 1985, then it fell considerably, fell to about 230 in September.

Mr. THUROW. Yes.

Chairman LAFALCE. Then from September it has fallen to roughly 180. At least we are using the yen as the yardstick here, but was it coordinated intervention that caused the fall from September? What caused it to decline from February to September?

Was coordinated intervention all that important, or was it just the announcement that there would be intervention while it was in the process of falling or other reasons that helped cause it to fall?

All those questions are my first question.

The second question, is it really that the dollar is falling or the yen is becoming internationalized and the yen is rising?

How do you account for the fact that although the dollar has fallen or the yen has risen when you look just at that one currency, if you look at the currency of our largest trading partner—and that is not Japan—Canada is, with which we have a much higher trade deficit per capita than Japan by far, with which country we

are presently discussing the establishment of a free trade zone, that the dollar has risen in value since September?

Mr. THUROW. One answer is you are now asking us to be the equivalent of those 5 o'clock in the afternoon stock market reports where they always tell you why on that day the stock market went up and down, and they always have an answer. My comment is if they were useful why didn't they put them on at 8 o'clock in the morning as opposed to 5 o'clock in the afternoon.

The important thing to understand——

Chairman LAFALCE. With hindsight, you know.

Mr. THUROW. The important thing to understand is when there is a lot of random noise in these markets with things going up and down, the other thing is in some sense you ought to be addressing at least part of that question to a psychiatrist rather than a businessman, economist, or labor union leader.

Because you are asking something equivalent, for example, of why did tulips sell for $10,000 a bulb in Holland in 1637? Because if you went back to the level of the dollar in late February and early March 1985, I think economic historians will see that as the equivalent of tulips because if the value had stayed where it was in March 1985 for a 5-year period, the whole American economy would have had to have closed down.

Nothing in America could be competitive. I literally mean nothing at 3.3 marks to the dollar and 280 yen to the dollar. The whole thing would have fallen apart. Then if you start talking about timing, then it becomes very complicated because you see you are asking a question which economic historians cannot tell you to this day about the stock market crash of October 1929.

Why did the stock market crash in October 1929? You can give a complicated story of why it was overvalued, but it doesn't tell you why October, it could have been May, March 1930—the economy stopped growing in 1926, farmers went into recession in 1925, there was a lot of speculation, et cetera, et cetera, but none pins down the dates.

So, I think if you are trying to explain historically why it went up and down over relatively short periods of time, the answer is nobody knows and nobody will ever know why those short-term movements exist, although we know in the long run as of March 1985 the dollar was grossly overvalued, and it had to come down if we were not to shut down the American economy and the American economy was not going to be shut down.

Mr. CHOATE. I would take it a step further, it leads then with both your question and Professor Thurow's answer——

Chairman LAFALCE. Your answer leads me to believe I shouldn't ask questions.

Mr. THUROW. No, no.

Mr. CHOATE. But there is a real policy implication here. That is what are the implications of this for our competitiveness. Let's use the numbers that Secretary Baker and the Department of Commerce would use in which they said that half our trade balance was due to the dollar.

What is going to become very clear as the dollar falls or stays at the present level is that we are still going to run massive trade deficits. I would be very surprised if it is only a $75 billion trade

deficit next year. It will certainly be a massive trade deficit this year.

What this is going to do is make clear the fact that our decline in competitiveness over these past 4 or 5 years is not simply a matter of exchange rates. That there are more fundamental structural issues afoot here that have been left unaddressed and unattended for far too long.

It is going to make it very clear that Government has a definite role to play in addressing these kinds of issues.

The challenge I come back to is, once that becomes clear, then the question is then what do we do?

If it is going to be a strategy, if we are going to make that response in the context of a strategy, how are we going to see that the parts, the pieces fit into a coherent whole? Today we lack the mechanisms to do that analysis, and to bring those parts into a whole. I keep coming back to this. We are in very dangerous times. We are in a very unforgiving circumstance.

If we make mistakes in the late 1980's it will not be like the 1960's where you have such strength standing behind you that you will not have massive declines in your standard of living as Professor Thurow is suggesting could occur here, we have used up our degrees of forgiveness in this situation.

We must very carefully consider our actions.

We need the mechanisms again and the processes by which we can consider carefully what we are doing.

Chairman LAFALCE. We are in 100-percent accord on the mechanism. I will ask the macroeconomist this question as to whether the dollar has dropped or the yen increased, and then why are the dollars increasing against the Canadian dollar. And Canada is our largest trading partner and with which we are discussing free trade and which happens to border my congressional district with four bridges, and therefore is of special sensitivity to me.

Mr. SCHECHTER. I think there was some growing recognition of the internationalization, if you will, of the economies of the world. So, that when we were keeping our interest rate high and attracting all the dollar investments here in Europe, they were suffering from slow growth to some extent. They were afraid to lower their rates more. They would have more outflow of capital.

And there certainly was a desire that U.S. interest rates come down some and that would mean lowering the value of the dollar, and I think as a result, probably, of the consultations that take place from time to time, finally there was some agreement reached to do something in concert.

Of course we had been getting to a somewhat lower interest rate, and I think that explains some of the earlier 1985 lowering of the value of the dollar. We were being flooded with foreign investors from Japan and Europe who wanted, needed dollars.

Finally when the push came in September, the coordinated push to force the dollar down by intervention, you also have the factor that international exchange gambling, if you will, is very big. I heard something like $1 trillion a day playing in currencies—$1 trillion a day.

So that once it was announced and the intervention started, there was a great deal of people who wanted to hop on that

bandwagon and sell dollars and buy yen so that as a result I think that helped bring about the result.

Mr. THUROW. It should be said that the Japanese Government has been very aggressive so far in terms of raising the value of the yen.

So, I think where we are at now in both Europe and Japan is a feeling their currencies have risen to the level where if they start to rise higher, they will start to lose jobs in a massive way. I don't think we will get cooperation in lowering the value of the dollar or raising the yen or mark.

Chairman LAFALCE. Our trade deficit is what now?

Mr. THUROW. $50 billion.

Chairman LAFALCE. In a country of 100 million. What is our trade deficit with Canada?

Mr. THUROW. $22 billion.

Chairman LAFALCE. Isn't it larger than that?

Mr. THUROW. No, I think it is $22 billion. You can think of the trade deficit as $50 billion with Japan, $50 billion with Europe and Canada, and $50 billion with the rest of the world.

Now, of course a $22 billion deficit with Canada is enormous because they only have 25 million people, the Japanese have 117 million people. On a per capita basis, the Canadian trade surplus is enormous compared to the Japanese trade surplus.

Chairman LAFALCE. Anybody care to make a guess as to why we have not had some realignment in the United States/Canadian dollar?

Mr. THUROW. I think the big reason is traditionally a lot of capital has flowed into Canada to finance the natural resource investments which are very capital intensive, investments in tar sands, in oil, in nickel, in mining. Those all absorb enormous capital and that capital typically came from the United States into Canada.

At the moment you have a flow of capital out of Canada, and I think the basic reason is that all of those capital intensive industries are depressed because of world prices. Nobody is investing in oil, nobody is investing in tar sands, nobody is investing in gold, nickel, nobody is investing in uranium, and so those big capital intensive activities in Canada are exporting rather than importing capital. If you wrote me an exam question where I had to give an answer on the test, I would put that down as the most likely answer.

What you have there is if it was an underdeveloped country we would call it capital flight, you just have a lot of Canadians moving capital out of Canada.

Mr. TORRES. If I may, Mr. Chairman.

Chairman LAFALCE. Sure, any time.

Mr. TORRES. In response to the question of the declining value of the dollar that the chairman asked, regarding the coordinated effort by Secretary Baker to convene the meeting in New York with the Minister of Finance, the G–5, did that direct government intervention have an effect?

Mr. THUROW. I think absolutely, because they literally spent billions of dollars, they just didn't have an announcement. They spent billions of dollars and in particular—nobody knows for sure but the

Japanese Government may have put $20 billion into that effort; that is not trivial money.

Even though there is a——

Mr. TORRES. $20 billion into what effort?

Mr. THUROW. Into raising the value of the yen.

Even though there is $1,000 billion a day going through national currency markets, one must understand a phenomenon. Think about the futures markets for grain and the current market for grain. If you look at futures trading, it is much bigger than the current market. One of the problems at the beginning of the financial collapses of the Great Depression, the people believed the futures markets were more important than the actual current markets for grain.

Futures markets kind of do crazy things in the short run, but in the long run the price of wheat is determined by how many want to buy and sell wheat, not how many gamblers want to speculate on futures contracts.

So, $20 billion may not sound like much, but that is real money. The gamblers in the international markets are buying and selling a piece of paper. They don't have 20 billion dollars worth of real money to put into the system—$20 billion may not look like much compared to $1,000 billion. If you look at the real money gambled as opposed to the papers being shuffled, $20 billion is a substantial fraction of the real money.

Mr. TORRES. Given the serious trade imbalance, given the serious deficit problem we suffer, given the debtor nation status we now enjoy, and it appears that for the future we will continue in that trend, at the risk of sounding naive, why is it that we continue in this trend at a Government level? Why is the leadership of this country, given your analogy again of the motor car in Massachusetts with the person going ahead of it with a lamp, still continuing to operate under these arcane systems?

Mr. THUROW. Could I be a little bit flip?

Mr. TORRES. I want you to. I want to understand.

Mr. THUROW. I honestly think it is because the President of the United States has seen too many movies. I will tell you why. When he rolled that phrase out on his State of the Union message which was that we could outmarket, outsell, outproduce everybody else in the world, he was remembering John Wayne movies where the Americans always win. If we just kind of act tough we win the wars, and we win the economic wars. I think in his heart of hearts, he believes it.

The idea out there that competitors are as good or better than Americans economically has never sunk into the gentleman.

You know, the facts may——

Mr. TORRES. We are operating under a B movie mentality?

Mr. THUROW. We are operating under a scenario which reflects the reality of 1955 as opposed to the reality of 1986. Let me give you a number to illustrate it.

I don't know whether these numbers float through the President's mind or not, but they ought to. The Japanese equivalent of Wall Street Journal asked the 2,000 largest firms in Japan, do you think your technology is worse than that of your American compet-

itor, equal to that of your American competitor, or better than that of your American competitor?

Well, 11 percent of the firms said worse, 64 percent said equal, and 25 percent said superior.

Well, I don't think the President of the United States comprehends that 25 percent of all the big firms in Japan think they are better than their American competition and they have the data to prove it—the $50 billion trade surplus.

It isn't until you reflect that reality that you are losing the war, you are not winning the war, you are losing the war, that you are willing to think about doing something new. As long as you really believe Americans can outmarket, outproduce and outsell anybody in the world, why would you change the system?

Mr. TORRES. Mr. Thurow, I was reluctant to ask the question, but I am happy I did. Thank you.

Mr. SCHECHTER. I share the Professor's view of our President, but I think our own economics profession may bear some of the blame, too.

There is an overwhelming belief in free trade as though the world is a free trade world, and we shouldn't, therefore, try to make different rules, but just go along on this belief.

A few years ago, I forget when it was, there was a petition signed by 4,000 economists objecting to any measure that would interfere with free trade.

So, I think there is a lag intellectually here, not as great of course, but not just in the party of the President.

Chairman LAFALCE. Henry, has the AFL–CIO taken a position or done any work on the proposal for free trade zones between the United States and Canada?

Mr. SCHECHTER. I think we have no position on that at this point.

Chairman LAFALCE. OK. If you start doing research on that, please share your thoughts with us.

Mr. SCHECHTER. Don't forget we have some of our unions that are international and the internationals involve people in Canada.

Chairman LAFALCE. Do you have any questions, Mr. Carper?

Mr. CARPER. I apologize for being late, I have three subcommittee meetings.

Chairman LAFALCE. I understand your priorities.

Mr. CARPER I look forward to reviewing the statements. I understand from Mr. Torres they were excellent.

I will review your statements, thank you.

Chairman LAFALCE. Based on all you have heard, you are allowed to ask whatever questions you would like.

Mr. WORTLEY. That is wonderful. I yield back the balance of my time.

Chairman LAFALCE. We are just about concluded.

Mr. Thurow, Mr. Schechter and Mr. Choate, again I want to extend the thanks of the entire subcommittee for your invaluable comments on what I consider an extremely important legislative initiative, and one the subcommittee, committee and full House and the Congress will address in the days and weeks ahead.

Thank you very much.

[Whereupon, at 11:25 a.m., the subcommittee was adjourned.]

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